

# IRS News Release

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## **IRS Offers Tips for Accurate Schedule K-1 Filing**

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WASHINGTON — The Internal Revenue Service today provided tips to businesses, individuals and tax professionals to avoid errors on Schedules K-1. The Schedule K-1 is used to report income from partnerships, S corporations and some trusts.

Accurate filing of the forms is important because the IRS continues to match income from Schedules K-1 to other tax returns.

Changes to forms, greater outreach, and enhancements to the matching program were among the recommendations made in 2002 by a study group comprised of tax professionals and the IRS.

The form and instructions for the tax year 2003 Schedule E, Supplemental Income, contain enhancements designed to improve Schedule K-1 reporting accuracy. A redesigned Schedule K-1 for partnerships and S corporations is expected to be available for tax year 2004.

For tax year 2002, approximately 25 million Schedule K-1 forms were filed reporting over \$1 trillion in income to partners, shareholders and some trust beneficiaries. A matching program to ensure all Schedule K-1 income is being reported is critical to the IRS' tax administration policies.

To reduce errors the IRS encourages electronic filing of Schedules K-1 and other tax forms. Additional reminders to businesses, individuals and tax professionals include:

### **For flow-through entities issuing Schedules K-1**

- Ensure the correct taxpayer identification numbers are used on Schedules K-1, particularly those issued to owners of entities disregarded for federal tax purposes (i.e. Single Member Limited Liability Companies). In these situations, Schedule K-1 must be issued to the owner of the entity and reflect that owner's identification number.
- Identify "amended" information by checking the appropriate box on the Schedule K-1.

### **For recipients of Schedules K-1**

- Report income in the proper location on individual returns as instructed on Schedule K-1, column C.
- Avoid netting or combining income against losses or expenses. Gross income should be reported separately from other related deductions, such as unreimbursed partnership expenses or Section 179 expenses. Refer to the Schedule E instructions for information on properly accounting for deductions related to Schedule K-1 income.
- Report deductible “At Risk” or Basis Limitation losses carried forward from prior years on a separate line from current year transactions. Do not combine (net) them with any current year amounts. Refer to Form 8582, Passive Activity Loss Limitation, for instructions on properly deducting passive activity losses. Beginning with tax year 2002, Form 8582 worksheets are required to be attached to the return.
- Identify “estimated” K-1 income. When the Schedule K-1 has not been received at the time the Form 1040 is filed, the income should be estimated. Form 8082, Notice of Inconsistent Treatment or Amended Return, should be used to identify estimated K-1 income or when the investor disagrees with the amounts reported on the K-1.
- Report elections authorized by Rev. Proc. 2003-79 properly. This revenue procedure allows partners and shareholders impacted by a partnership or S corporation’s election to change to an annual accounting period to apply a four-year ratable spread to the portion of the income attributable to the short tax year. Section 6 of the revenue procedure provides specific instructions that should be followed to ensure the ratable portion of the income is properly reported on the partner or shareholder’s individual tax return.

The IRS also implemented this year two initiatives that will have a positive impact on the transcription quality of paper forms K-1. While electronic filing is the preferred method of filing, two-dimensional (2-D) bar coding and Optical Character Recognition (OCR) scanning have both been incorporated in the processing of paper forms K-1.

The IRS will scan the bar code and use a combination of bar code, OCR and manual transcription technology to process the K-1s. These improvements will reduce taxpayer burden by causing fewer transcription errors and will also increase the efficiency of IRS operations.

The latest revision of IRS Federal Tax Products CD-ROM (Publication 1796) and certain tax software packages include bar code enabled forms K-1. And the enhancement will soon be added to the fillable Schedules K-1 on IRS.gov for those who do not need tax preparation software to perform calculations.

The IRS is in the final stages of the tax year 2001 matching program and will begin matching 2002 documents before year end. Additional filters and screening enhancements implemented last year have improved the overall effectiveness of the matching program. The IRS continues to analyze closed K-1 matching cases for taxpayer burden reduction and program enhancement opportunities as well as additional outreach and education needs.